

CollegeCounts 529 Board Meeting
August 8, 2012
9:00 a.m.
MINUTES

Board Present:

Chair Young Boozer
Mr. Dennis Beavers
Mr. Chess Bedsole
Dr. Greg Fitch
Lt. Governor Kay Ivey
Ms. Leigh Grogan for Chancellor Susan Price
Mr. Mychal Smith
Mr. Ronald Stokes

Board Absent:

Mr. Daniel Hughes, Vice Chair
Dr. William Meehan

Others Present:

Ms. Daria Story, Assistant Treasurer
Ms. Glenda Allred, Deputy Treasurer
Mr. Chad Wright, Program Director
Mr. Jay Steinacher, Union Bank & Trust
Mr. William Shafferman, Union Bank & Trust
Mr. Trevor Jackson, Wilshire Associates
Mr. Mannik Dhillon, Wilshire Associates
Mr. Jeremy Thiessen, PCA Consultants
Mr. Eric White, PCA Consultants

Pursuant to written and public notice, the meeting of the Board of Directors of the CollegeCounts 529 Fund was held in the RSA Union Building, 6th Floor Conference Room on August 8, 2012.

Agenda Item 1.

The meeting was called to order by Chair Young Boozer at 9:00 a.m. He announced the re-appointment of Mr. Mychal Smith to a new four year term as a board member.

Agenda Item 2.

Chair Boozer presented the minutes of the May 9, 2012 board meeting. A motion for approval of the minutes was made by Mr. Beavers, seconded by Mr. Bedsole, with unanimous approval.

Agenda Item 3.A.

Chair Boozer called on Mr. Jay Steinacher for the quarterly program review. Mr. Steinacher stated that the second quarter of 2012 was another good period for the program. He noted that the total assets in the plan were stable at \$853 million and that contributions to the plan

continued to be strong. Total contributions for the quarter were \$27.9 million, with \$17.2 million coming from Alabama families (a 35.6% increase over 2011). Total program accounts are now at 60,741 with 21,116 of those being Alabama accounts. He indicated that rollover contributions continue to be strong as well. For the quarter, 901 rollovers totaling \$14.3 million were made to the Advisor Plan (Avg rollover of \$15,883) and 300 rollovers totaling \$5.8 million were made to the Direct Plan (Avg rollover of \$19,279). Year to date, there have been 3,787 new accounts opened. Of those, 2,966 are new Alabama accounts. Based on current trends, he anticipates that there will be 6,000 – 6,800 total new accounts opened this year. Mr. Steinacher then discussed the overall plan asset allocation for the Direct and Advisor plans and stated that the plans are well diversified. He stated that the equity positions of the plans (64.9% equities in Direct and 66.3% equities in Advisor) indicated that participants are making efforts to offset tuition inflation. He then mentioned that the first half of the year was excellent and he expected the traditional and grass roots marketing efforts to make for a very successful end of the year, as well.

The complete June 30, 2012 report is attached for reference.

Agenda Item 3.B.

Chair Boozer called on Mr. Trevor Jackson and Mr. Mannik Dhillon of Wilshire Associates for the investment performance report. The detailed quarterly report was received for information and is attached for reference.

Mr. Jackson indicated that there was a great deal of change and volatility within the markets during the second quarter due to continued uncertainty in Europe and China along with the uncertainty that typically occurs during a U.S. election year. Mr. Jackson stated that earnings for U.S. companies were high quality early in the year and, while they remained strong in the second quarter, there was some degradation of earnings during the period, leading to additional uncertainty among investors. He mentioned that U.S. markets continue to be among the strongest in comparison, but there is still a lot of fear about what the future holds. He stated that the recent stock market rally (since 6/30) could be attributed to the potential for Federal interaction in the marketplace and the reporting of reasonable jobs growth numbers.

Mr. Jackson stated that U.S. market returns have been down across the board. During the second quarter, both large and small cap indexes were down approximately 3%, non-U.S. equities down 7.6%, and emerging markets down almost 9%. Market volatility led to investors seeking the safer havens of the fixed income market which pushed long term Treasury returns over 10% and corporate high yield returns to 1.83% for the quarter. Mr. Jackson also mentioned that investments in real estate have done very well year to date, with returns on non-U.S. real estate at 17.7% and global real estate at 16.3% respectively.

Mr. Jackson reported on the target portfolio within the direct plan, stating that returns were down marginally quarter to date and up slightly year to date. He stated, however, that they had no concerns about the portfolio due to the fact that the holdings are primarily passively managed and the returns were as expected. Within the advisor plan, returns were flat for the fixed income managers while the active equity managers underperformed slightly as a whole. Mr. Jackson mentioned that the year to date numbers were still holding strong.

Mr. Dhillon summarized and discussed the individual portfolios and the pressure that has been placed on active managers due to the volatility and uncertainty of the markets. Mr. Dhillon specifically mentioned that the Fidelity Advisor Mid-Cap II fund continues to underperform its benchmark and its peers and stated that Wilshire recommends replacing the fund with the

Vanguard Mid-Cap Index Fund in the direct plan and with the Northern Mid-Cap Index Fund in the advisor plan.

Agenda Item 3.C.

Chair Boozer called on Mr. Jeremy Thiessen of Pension Consulting Alliance, Inc (PCA) for the consultant's analysis. Mr. Thiessen introduced Mr. Eric White from the PCA office in Sacramento, California. He then discussed investment market risk metrics and how they take segments of the market and compare them to their historic mean to determine whether or not the segment is favorably or unfavorably priced and also determine equity volatility, yield curve slope, break-even inflation and interest rate risk. **Mr. Thiessen then stated that there were no changes to any of the funds' performance status for the direct or advisor plans.** For the advisor plan, the Harbor Large Cap Value Fund, Fidelity Advisor Mid Cap II Fund, BlackRock Inflation Protected Bond Fund and PIMCO Total Return Bond Fund remain on watch. For the direct plan, the Fidelity Advisor Mid Cap II Fund and the PIMCO Total Return Bond Fund remain on watch. He mentioned that performance of these funds remains mixed, and that while the PIMCO fund performance has improved, it was not to a degree that warranted removal from "watch" status. There were no new funds that qualified for a status change.

Agenda Item 3.D.1.

Chair Boozer called on Mr. Jackson and Mr. Dhillon for a review of the current asset allocation for the direct and advisor plans and for new fund recommendations. A detailed review of allocations and fund recommendations were received as information and are attached for reference.

Mr. Jackson began by saying that asset allocation is vital in order to achieve incremental return and reduced volatility within a portfolio over time. He stated that a key advantage that Wilshire has is its Trust Universe Comparison System (TUCS), which is a proprietary database representing \$2.8 trillion in assets with the allocation decisions of some of the largest institutions in the world over the last 30 years. He stated that the focus was on overall portfolio/program evolution and offered the following enhancements for consideration based on their research:

DIRECT PLAN:

- Increase the overall international equity allocation in all age-based portfolios
- FDIC insured option

ADVISOR PLAN:

- Increase the overall international equity allocation in all age-based portfolios
- Increase the emerging markets allocation relative to the overall non-U.S. allocation
- Addition of key asset classes (international bonds, international small cap, high yield and commodities)
- Replace current domestic REIT with a Global REIT
- FDIC insured option

Mr. Jackson summarized the recommended allocation guidelines for the direct and advisor plans. He stated their recommendation of increasing non-U.S. equities in the direct plan at the higher risk profiles (increasing the fund 100 allocation by 8%, fund 80 by 7%, fund 60 by 6% and fund 40 by 2%). Mr. Dhillon stressed that these changes were being made as a strategic recommendation and not as a result of market timing. Mr. Jackson stated that no new managers were being added to the direct plan and that the changes would simply be to increase the allocations among existing funds. He then made the comparison of asset class returns with

the marginal increases in risk and provided information on the 10 year “back-test” which indicated historical returns at the current and new allocations versus the benchmark.

Mr. Jackson then provided the recommended allocation changes for the advisor plan. First, he discussed the recommended increase to non-U.S. equities (same percentage increases as the direct plan). He then reminded the board that Wilshire was recommending the additional asset classes:

- High Yield—4% increase to fund 20, 3% fund 40 and 60 and 2% fund 80
- Global REIT—1.5% increase to fund 40, 3% fund 60, 5% fund 80 and 7% fund 100
- Commodities—1% increase to fund 20, 2% for fund 40, 60, 80 and 100
- International Small Cap—2% increase to fund 60, 3% fund 80 and 4% fund 100

He then discussed the “back-test” information for these fund classes. Finally, Mr. Jackson summarized how these changes affect the weighted average fees and the comparison of risk and return.

Agenda Item 3.D.2.

Mr. Dhillon provided a summary of the individual fund recommendations for the new asset classes based on Wilshire’s research. He provided key characteristics for each fund manager including fees, assets, key professionals, tracking error, turnover and investment style. In addition, he summarized Wilshire’s qualitative ratings for each based on six components. He then provided historical performance data for the funds. Based on these factors, he provided a first and second recommendation for each fund class:

- International Small Cap: 1) DFA International Small Company 2) MinStay Epoch International Small Cap
- Non-U.S. Bonds: 1) Templeton International Bond 2) Wells Fargo Advantage International Bond
- High Yield: 1) Touchstone High Yield 2) Prudential High Yield
- Commodities: 1) Credit Suisse Commodity Return Strategy 2) PIMCO Commodity Real Return Strategy

Agenda Item 3.D.3.

Chair Boozer summarized the memo on 529 plan FDIC insured products that was provided by AKF Consulting. He stated that the option was a very safe (insured up to \$250,000), low return product that has not been offered within the program before. Due to the concerns of investors in the recent past regarding risk and safety, some states have begun offering the option within their 529 plans. Mr. Thiessen provided additional comments regarding the various states that currently offer the option and mentioned that the industry has seen an increase in the number of plans offering the option since 2010.

Agenda Item 3.D.4.

Chair Boozer called on Mr. Thiessen to summarize his review of the recommendations made by Wilshire. Mr. Thiessen stated that PCA was in agreement with the recommendations made. He then mentioned that if changes to asset allocations were approved, that would necessitate the need for changes to the monitoring guidelines in the future.

A motion to accept the Wilshire recommendation for asset allocation changes to the direct plan was made by Mr. Beavers, seconded by Lt. Governor Ivey, with unanimous approval.

A motion to accept the Wilshire recommendation for asset allocation changes to the advisor plan was made by Mr. Bedsole, seconded by Mr. Stokes, with unanimous approval.

A motion to accept all of the primary fund recommendations by Wilshire was made by Mr. Bedsole, seconded by Mr. Beavers, with unanimous approval. These funds are DFA International Small Company, Templeton International Bond Fund, Touchstone High Yield and Credit Suisse Commodity Return Strategy.

Chair Boozer suggested that the data on the FDIC product be utilized for informational purposes only at this time for consideration at a future meeting after additional data has been collected.

A motion for approval of Wilshire's recommended changes regarding the Fidelity funds was made by Mr. Beavers, seconded by Mr. Smith, with unanimous approval.

Agenda Item 3.E.

Chair Boozer called on Mr. Chad Wright for the program report. Mr. Wright provided information on the program budget, asset statements, and scholarship application and website timeline. Mr. Beavers requested that the timeline be adjusted so that scholarship recipients could be notified by May 1st so that they could be recognized at their school's awards day.

Agenda Item 4.A.

Chair Boozer summarized the June 5 Investment Committee meeting and action. He then provided a resolution to ratify the action taken by the committee. A motion to approve the resolution was made by Lt. Governor Ivey, seconded by Mr. Bedsole, with unanimous approval.

Agenda Item 4.B.

Chair Boozer called on Mr. Steinacher to provide information regarding the proposed increase in the maximum contribution limits allowed by the program. Mr. Steinacher explained that the current contribution limit is \$300,000 per beneficiary. He stated that the maximum limit of any plan nationwide is \$400,000 with the midpoint being approximately \$320,000. He stated that the program currently has 19 accounts with balances over \$250,000 and 7 accounts over \$300,000. He recommended changing the contribution limit to \$320,000, but stated that they were comfortable with an amount up to \$350,000.

A motion to increase the maximum contribution limit to \$350,000 was made by Lt. Governor Ivey, seconded by Mr. Beavers, with unanimous approval.

Agenda Item 4.C.

Chair Boozer called on Mr. Steinacher to discuss proposed changes to the existing program disclosure statements based on the asset allocation changes that were approved earlier in the meeting. Mr. Steinacher outlined the recommended changes that would be necessary and proposed an early October timeline for implementation. In addition, the Treasurer would be authorized to approve any additional minor revisions needed to complete the disclosure statements prior to final implementation.

A motion to approve the proposed changes to the disclosure statements was made by Lt. Governor Ivey, seconded by Mr. Bedsole, with unanimous approval.

Agenda Item 4.D.

Chair Boozer provided a draft of an investment policy for the Opportunity Enhancement Fund (Scholarship Fund). He explained that the policy was drafted to outline the responsibilities of

the board and direct that funds be invested at the same allocation as the direct plan (60% equities/40% fixed).

A motion to approve the Opportunity Enhancement Fund investment policy as proposed was made by Mr. Beavers, seconded by Mr. Bedsole, with unanimous approval.

Agenda Item 4.E.

Chair Boozer provided a draft of ACES bylaws for consideration by the board. He stated that they were being proposed to establish and direct the responsibilities and activities of the board.

A motion to approve the ACES bylaws as proposed was made by Mr. Bedsole, seconded by Mr. Beavers, with unanimous approval.

Chair Boozer then stated that the investment committee is currently composed of himself and Mr. Hughes, Vice Chair. He asked if any board member would like to join the investment committee, with Mr. Bedsole and Mr. Beavers volunteering.

Agenda Item 5.A.

Chair Boozer directed board members to an informational memo from PCA to its clients regarding pending litigation against their firm.

There being no further business, the meeting adjourned at 12:00 p.m.

Chad Wright, Recording Secretary

Young Boozer, Chair